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How many monies does Africa need?

Thorvaldur Gylfason
University of Iceland

Despite Africa's great diversity of culture and languages, many Africans identify themselves as Africans first, then as Congolese, Kenyans, Nigerians, South Africans, and so forth. Most Europeans, North Americans, and Asians have it the other way round: country first, then continent. Even so, national boundaries within Africa are generally less open than those within Europe due to a variety of legal and regulatory restrictions that hamper the cross-border flow of goods, energy, services, capital, and labor. Many of these restrictions need to be relaxed to spur growth. For example, a pan-African energy grid could greatly reduce the cost of energy across the continent and make air conditioning affordable to vastly larger numbers of households and businesses. The taming of the Congo River with one-sixth of the world's harnessable hydro-energy potential promises to deliver inexpensive power, through three electricity superhighways: south to Angola, Botswana, and South Africa, west toward Nigeria, and north to Egypt and even Europe. In his memoirs, *The Singapore Story* (1998), Lee Kwan Yew, former Prime Minster of Singapore, describes how air conditioning catapulted his country to prosperity when the stifling heat gave way to cool air indoors. But we digress.

Does every country in Africa need a currency of its own? No. Because national currencies constitute an exchange and trade restriction, a further reduction of the number of currencies in Africa would likely encourage trade and growth in Africa. This is why the African Union aims at pooling all the continent's currencies into a single currency by 2028. In the meantime, several regional monetary unions are on the drawing board in addition to the two monetary unions already in existence, one *de jure* and the other *de facto*. First, fourteen countries belonging to the Economic and Monetary Community of Central Africa and the West African Economic and Monetary Union use the CFA franc. Second, Lesotho, Namibia, Swaziland, and now also Zimbabwe, use the South African rand. Botswana used the South African rand for ten years following independence, 1966-76, before introducing the pula.

The Nigeria story

Before independence, pound sterling was Nigeria's legal tender. With the establishment of the Central Bank of Nigeria in 1959, the Nigerian pound became the nation's new currency. Nigeria's population at independence in 1960 was 42 million compared with 52 million in Britain. The exchange rate was a pound for a pound: one Nigerian pound was equivalent to one British pound. This arrangement remained intact until 1973 when the British adopted the decimal system in their monetary affairs. That year they stopped dividing the pound into twelve shillings and each shilling into twenty pence as they had done for ages. Instead, the pound was now divided into a hundred new pence. That year, 1973, Nigeria adopted a new currency, the naira. The exchange rate remained unchanged at one to one: one naira was equivalent to one British pound.

This arrangement did not last, however. Over time, the naira weakened because Nigeria's macroeconomic policies were inadequate. Government expenditure exceeded federally collected revenue despite rapidly rising foreign exchange earnings from oil exports after 1970. The federal government's budget deficits were financed through borrowing at home and abroad and through money creation which led to inflation and a depreciation of the new currency. Today, it takes 220 naira to buy one British pound. This means that, since 1973, the naira has depreciated by fifteen percent per year on average vis-à-vis the pound. The unofficial exchange rate of the naira is now about twenty percent lower than the official exchange rate due to currency restrictions on certain current as well as capital transactions. For example, those who want to purchase certain luxury items cannot normally buy foreign exchange from the banks for this purpose, but they can try their luck in the black market where virtually anything is available if the price is right. Nigeria is a well-functioning market economy.

From monetary independence to inflation

The establishment of the naira as Nigeria‘s national currency in 1973 was intended to bolster the country‘s independence by making it possible for the Central Bank of Nigeria to pursue an independent monetary policy. It was also a matter of national pride. The thinking behind the new arrangement was that an independent and flexible monetary policy would serve the nation‘s interest better than a fixed exchange rate between the naira and the pound which, in practice, had been equivalent to using the pound as if it were Nigeria's national currency. What happened, however, is that from 1973 to date the naira depreciated by 99.5 percent against the pound. This depreciation would perhaps be justifiable had Nigeria managed to use easy money to narrow the gap separating the standard of living for ordinary Nigerians from the general standard of living in Britain, but that is not what happened. The purchasing power of national income per person in Nigeria is now fifty percent lower relative to Britain's than it was in 1980.

In view of this experience, Nigeria now has plans to abolish the naira in favor of joining a monetary union with four or five other West African countries (The Gambia, Ghana, Guinea, Sierra Leone, and perhaps also Liberia). The planned monetary union, until recently envisaged to be launched in 2009, has now been put on ice partly because of fears among the smaller countries of being swamped by Nigeria, by far the most populous country in the group (155 million out of 200 million in the six countries combined). Some also fear diluted sovereignty when the new Central Bank of the West African Monetary Zone takes over some of the policy making responsibilities of individual national central banks, but that, of course, is the chief purpose of a monetary union. The new West African Central Bank will be located in Accra, the capital of Ghana (24 million). The central bank of a monetary union does not belong in the capital of the union‘s most populous country. The success of the European Union and of the euro since its launch in 1999 has made an impression in Africa.

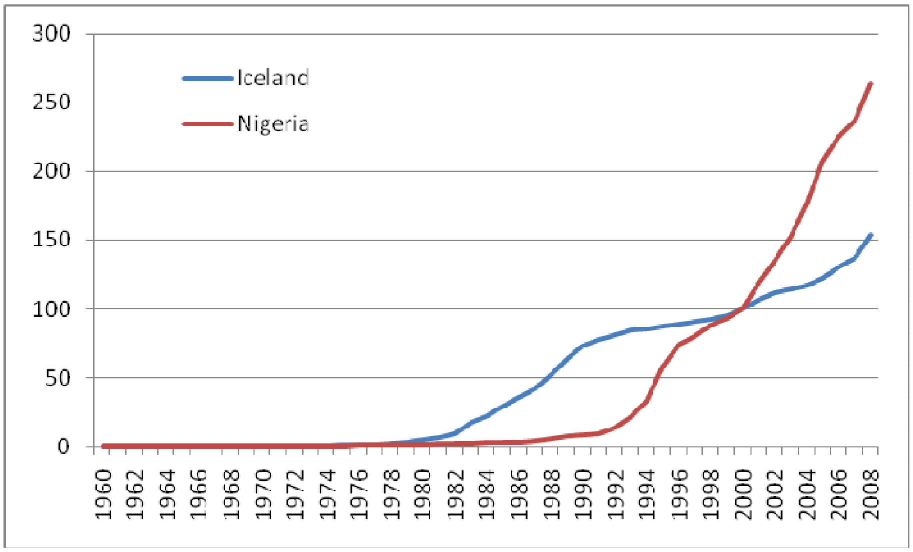
Fewer currencies than countries

The world‘s currencies are declining in number as more and more nations eye the potential benefits of sharing currencies with their neighbors. Currencies are like democracies, to paraphrase Winston Churchill: the best way to preserve their integrity is to share them. When the West African Monetary Zone comes into being, the number of currencies in Africa will equal about half the number of countries. And when the East African Community re-emerges as scheduled with its five members (Burundi, Kenya, Rwanda, Tanzania, and Uganda), the number of the continent's currencies will be reduced by another four. A strive for efficiency dictates the use of fewer and larger currencies and so do foreign investors who are understandably wary of weak and volatile currencies. This centripetal force is opposed by a centrifugal force rooted partly in national pride but also, more importantly, in the belief that sovereign national currencies make it possible to pursue independent and flexible monetary policies to foster economic and social development. This was the vision of Nigeria's leaders even if things turned out differently.

How about Iceland?

Now, please fasten your seatbelts. The Icelandic króna was established in 1886 and maintained its parity with the Danish krone until 1920. Thereafter, the Icelandic króna lost a fifth of its value before re-attaining parity with the Danish krone in 1933, a parity that lasted until the outbreak of World War II in 1939. Until the war, the general level of prices in Iceland did not rise significantly more rapidly than in Denmark. During the war, however, prices in Iceland began to rise at much quicker pace than in Denmark because – you guessed it – Iceland's macroeconomic policies were inadequate. Therefore, the króna was bound to depreciate. Now, seventy years later, it takes 23 Icelandic krónur to buy one Danish krone. Actually, the exchange rate is 2,300 Icelandic krónur for one Danish because two zeros were chopped off the Icelandic króna in 1981. This means that, since 1939, the Icelandic króna has depreciated by 99.95 percent against its mother currency. Thus, since 1939, the exchange rate of the króna has fallen by twelve percent per year on average vis-à-vis its Danish namesake. Consumer prices in Iceland rose by eighteen percent per year on average during 1960-2008 compared with seventeen percent in Nigeria (see figure). The Central Bank of Nigeria has plans to chop two zeros off the naira, as Iceland did, should the advent of the West African Monetary Zone encounter an indefinite delay.

Was Iceland's inflation worthwhile? No. The inflation resulted from lax economic policies as well as from casual attitudes that were conducive also to an escalation of foreign indebtedness and to fractures in institutions, including fragile checks and balances and politically motivated mismanagement of the privatization of the commercial banks 1998-2003 that paved the way to the banking system's spectacular growth followed by a sudden and complete collapse in 2008. Even so, Iceland managed to catch up with Denmark: in 1904, when Iceland attained home rule from Denmark, Iceland's national income per person amounted to a half of Denmark's whereas today it is about the same. The current financial crisis seems unlikely to alter this arithmetic except perhaps briefly because Iceland's social and economic foundation remains strong. The fundamental things apply as time goes by. The crisis seems to have opened the eyes of many more Icelanders to the advantages of retiring the króna in favor of the euro and joining the European Union. The government of Iceland has now asked the parliament to approve an immediate application for EU membership. Stay tuned.



Iceland and Nigeria: Consumer prices 1960-2008 (2000 = 100)
(Source: World Bank, *World Development Indicators* 2008 plus updates from local sources.)